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Internal audit and oversight

Internal audit and oversight*

Report of the Administrator

Summary

The present report is submitted pursuant to the arrangements agreed upon by the Executive Board. The report provides details of internal audit and oversight services provided by the UNDP Office of Audit and Performance Review for the year ended 31 December 2001.

A recommendation for the Executive Board is included in chapter VII.

* The collection and analysis of current data required to present the Executive Board with the most up-to-date information has delayed submission of the present document.

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Contents

		Paragraphs	Page
	Introduction	1-2	3
I.	Developments in the UNDP oversight and accountability frameworks	3-7	3
II.	OAPR organization and resources	8	4
III.	OAPR initiatives to improve effectiveness and client service	9-10	5
IV.	National execution audit strategy	11-15	5
V.	Coordination with United Nations system oversight offices	16-17	6
VI.	Internal audit and related services	18-55	6
	A. General	18	6
	B. Advisory services and management reviews	19-20	7
	C. Internal audits of functions and headquarters units	21-25	7
	D. Internal audits and reviews of UNDP-executed projects	26-28	8
	E. Internal audits and reviews of country offices	29-50	8
	F. Results of control self assessment workshops	51	12
	G. Analysis of audit reports for national execution projects	52-54	12
	H. Investigation cases	55	13
VII.	Executive Board action	56	13
Annex I			
	OAPR organization and resources		14
Annex II			
	Definitions of standard audit opinion ratings used by OAPR		15

Introduction

1. The Administrator is pleased to provide the Executive Board with the sixth annual report on internal audit and oversight services provided by the UNDP Office of Audit and Performance Review (OAPR) for the year ended 31 December 2001.

2. In addition to those provided to UNDP, OAPR also provides internal audit and oversight services to the United Nations Office for Project Services (UNOPS) and to the United Nations Population Fund (UNFPA). Chapter II and annex I of the report relate to all three organizations. However, detailed discussions of the internal audit and oversight activities carried out on behalf of UNOPS and UNFPA are included as separate reports, which are being submitted to the Executive Board at its present session by the Executive Director, UNFPA (DP/FPA/2002/8) and by the Executive Director, UNOPS (DP/2002/13).

I. Developments in the UNDP oversight and accountability frameworks

3. The two key developments in 2001 included a comprehensive proposal for a new approach to audit, and the significant improvements in the UNDP justice system. These developments are briefly described below. The status of the two main oversight mechanisms in UNDP, the Management Review and Oversight Committee and the Oversight Group, is also summarized.

New approach to audit

4. In August 2001, UNDP created a task force to review the internal audit function. OAPR proposed significant enhancements to its audit approach in response to comments and suggestions made by task force participants and country office managers. Senior management responded favourably to the proposals during a retreat held in November 2001. In 2002, OAPR is piloting certain aspects of this new approach to gain feedback that will facilitate further improvements in the methodology. Key features of the new approach include:

(a) *Improved transparency of audit criteria and methodology for calculating overall rating*. The audit criteria will be shared with country offices to improve transparency and to encourage country offices to undertake regular self-assessments of performance;

(b) *More balanced assessment of performance*. Audit reports have, historically, focused on negative findings. As part of this new approach, the report will provide supporting explanations for each rating and will highlight good and innovative practices, areas for improvement and significant constraints preventing the office from achieving satisfactory performance. The audit team will also meet routinely with government official and key stakeholders to supplement the assessment of performance;

(c) *Multidisciplinary audit teams, drawing on staff members outside OAPR where appropriate*. Multidisciplinary audit teams will help to ensure that audit recommendations are practical and that assessments of performance are balanced. In addition, non-OAPR staff members will benefit from an increased understanding of internal controls;

(d) *Raising awareness of risk and internal control issues*. The mission will begin with a one-day session to raise the awareness of the office regarding internal control issues, including an assessment of the risks facing the office.

Improvements in the internal justice system

5. A review of the UNDP internal justice system, to improve management and procedural aspects of the system, was completed in March 2001. The objective of the review, undertaken by a team of independent consultants, was to ensure that disciplinary cases are treated in the fairest, most transparent and efficient manner, considering the rights and obligations of both staff and the organization. As a result of the review, UNDP has approved the establishment of a standing secretariat for the UNDP/UNFPA/UNOPS Disciplinary Committee, staffed by a trained lawyer and with defined terms of reference. At the same time, rules of procedures for the Disciplinary Committee have been drafted, based upon those currently being applied by the United Nations Joint Disciplinary Committee. It is expected that these rules will be approved in the second quarter of 2002. Next steps include the issuance of revised and updated disciplinary procedures, expected in the second quarter of 2002, setting out the rights and obligations of staff and the administration in the investigation and processing of disciplinary cases. Finally, a permanent, full-time, ombudsman function has been approved. Over the biennium, the capacity of the legal support functions in UNDP will be reviewed with a view to strengthening the function as appropriate.

Management Review and Oversight Committee

6. The Management Review and Oversight Committee (MROC) was established to provide the Administrator with assurance that the UNDP accountability framework is operating effectively. In support of this goal, MROC reviews UNDP oversight strategies and policies, including audit plans, and the results of oversight activities. Whereas the Oversight Group functions at the operational level, MROC operates at the strategic level, developing, implementing and monitoring plans for oversight activities. As reported in 2001, the membership includes the Under-Secretary-General, Office of Internal Oversight Services, the Associate Administrator, the Assistant Administrator and Director, Bureau of Management, the Director, Office of Legal and Procurement Support, the heads of the Oversight Group, and representatives of the regional bureaux. The Committee met in December 2001 and discussed the new approach to audit, the UNDP national execution audit strategy, and the improvements in the justice system.

Oversight Group

7. As reported to the Board at its annual session 2000 (DP/2000/21, para. 7), a mechanism, referred to as the Oversight Group, was introduced in the Administrator's Business Plans to maximize and coordinate the distinctive oversight roles of the Operations Support Group (OSG) and the Evaluation Office with the role of OAPR. The three units comprising this group continue to coordinate their work to strengthen links between the various oversight tools, which include evaluations conducted by the Evaluation Office, and random reviews conducted by OSG. In 2001, the members of the Oversight Group produced a set of indicators of country office performance, drawing on the results of oversight activities in each of the three units.

II. OAPR: Organization and resources

8. At headquarters, OAPR is organized into the Office of the Director and four sections: Internal Audit Section; Management Review and Analysis Section; UNFPA Audit Section; and UNOPS Audit Section. In addition, OAPR has three regional audit service centres, in Malaysia, Panama and Zimbabwe. As at 31 December 2001, OAPR had 44 authorized posts. Annex I contains details of the resources and staffing activities during the year.

III. OAPR initiatives to improve effectiveness and client service

9. The Comprehensive Audit and Recommendation Database System (CARDS), a web-based system for tracking and monitoring audit reports and recommendations, was introduced at the end of 1999. In mid 2000, OAPR instructed country offices to use CARDS to update the implementation status of recommendations. Initial compliance was low, but recent improvements in user-friendliness, better follow-up, including implementation rates in the management results framework, have recently improved compliance. Of 37 country office audits completed in 2001, a total of 15 offices used CARDS to report the implementation status of recommendations.

10. A new phase of the control self assessment programme began in 2001 with the training of a new team of facilitators and a revision of the management and support structure for the programme. Some significant changes implemented are: while participation in the programme continues to be voluntary, it is marketed to all resident representatives having recently taken up their posts and to all units at headquarters. A fee-for-service was instituted as a way to secure management commitment to the process and to offset a portion of the travel costs. Offices were requested to complete a survey on the services following the workshop, and an action plan is due 30 days after the session. This has been met with limited success so far and requires a more systematic approach in 2002.

IV. National execution audit strategy

11. In its resolution 55/220 of 23 December 2000, the General Assembly deferred approval of the UNDP financial statements for the period ended 31 December 1999, pending certification by the Board of Auditors that satisfactory progress was being made towards removing the reasons for the qualified opinion. The major component of the qualification was the lack of audit certificates covering the national execution expenditures reported in the financial statements. At its fifty-fifth session, the General Assembly approved the financial statements.

12. UNDP has taken aggressive measures to address the concerns expressed by the Board of Audit, the most significant is an increase in the level of audit coverage. Although an audit of all projects with expenditures over $100,000 is not required for management purposes, offices were instructed to arrange for such audits (1,623 projects), effective 2000; some flexibility was extended to country offices on an exceptional basis. Overall, country offices and governments have been very responsive. For the 2000 audit exercise, only five country offices (of the 116 country offices required to submit audit plans) failed to substantially complete their audit plan. Of these five, three had relatively small expenditures (under $500,000), one failed to provide an explanation, and the last is a country in special circumstances, which subsequently decided to audit the 2000 expenditures jointly with the 2001 expenditures.

13. In addition, OAPR has considerably strengthened its oversight role. Without increasing staff resources, OAPR has improved its monitoring of the audit exercise and follow-up of problems reported by auditors. With respect to the 2000 global audit plan, OAPR ensured that each country office prepared an adequate audit plan and continuously monitored receipt of audit reports against the plan, following up where delays were noted. Finally, OAPR assessed the overall performance of the audit exercise using criteria such as timeliness of receipt of audit reports, scope of the audits, adequacy of the audit plan, and adequacy of follow-up action taken by the country offices.

14. As reported in 2001, countries where the audit process is largely driven by international financial institution (IFI) deadlines were largely unsuccessful in meeting the UNDP deadline of 30 April. This is because IFI deadlines are generally later than 30 April and governments were understandably reluctant to undertake additional UNDP audits for the sole purpose of meeting UNDP deadlines. For the biennium 1998-1999, the late receipt of these audit reports was a major

contributor to the qualification by the Board of Audit. For the biennium 2000-2001, in consultation with the Board of Audit, OAPR has agreed to requests for extensions when the offices concerned have provided assurance that the audit reports will be completed within a reasonable period of time in accordance with IFI deadlines.

15. A key issue remains: there are wide variances in the quality and format of the audit reports. To address this, OAPR intends to provide guidance to country offices to help them to assess the capacity of national audit offices and/or in selecting private audit firms. More comprehensive terms of reference are also planned, including the format for the audit report and for the audit opinion.

V. Coordination with United Nations system oversight offices

16. OAPR coordinates its activities with members of the larger United Nations oversight system, including the Board of Audit, the Joint Inspection Unit (JIU), the Office of Internal Audit and Oversight Services (OIOS), and the internal audit offices of United Nations organizations. Ongoing activities include the coordination of audit activities with the Board of Audit and cooperation with OIOS on investigative activities. Furthermore, OAPR routinely participates in the annual meetings of representatives of internal audit offices of United Nations organizations and multilateral financial institutions.

17. In 2001 examples of cooperation include (a) consulting with OIOS on the terms of reference for the audit of projects in northern Iraq and (b) participating in a joint audit with OIOS on travel services. OIOS also undertook or participated in a number of investigations at the request of UNDP.

VI. Internal audit and related services

A. General

18. Overall, the level of outputs was relatively unchanged from that of the prior year. Table 1 summarizes OAPR output for 2001.

Table 1. Internal audit and oversight services provided in 2001

	In process as of 01/01/01	Projects initiated	Reports issued	In process as of 31/12/01
UNDP – Management reviews and advisory services		4	3	1
UNDP – Internal audits/reviews of functions/HQ units	2	5	3	4
UNDP – Internal audits/reviews of projects	-	1	1	-
UNDP – Internal audits/reviews of country offices	6	46	43	9
Subtotal: UNDP audits/review	8	56	50	14
UNDP – Control self-assessment sessions	-	16	16	
UNDP – Assessment of national execution audit reports	-	1626	1626	
UNFPA – Internal audits/reviews	13	27	30	10
UNOPS – Internal audits/reviews	6	19	20	5
Investigation cases	21	34	16	39

B. Advisory services and management reviews

19. OAPR seeks to add value to UNDP by providing advisory services in areas where OAPR has comparative advantages. Nonetheless, it is mindful of the potential for conflict of interest between audits and advisory activities. The reports issued in 2001 include a capacity assessment of a non-governmental organization (NGO) to execute a large UNDP project (carried out jointly with OSG), a review of the implementation of a new software package in a country office, and a review of security of the computer environment in a country office. In addition, an OAPR staff member participated in the random review of regional projects, an exercise led by the Operations Support Group.

20. A management review of a regional bureau was also initiated to assess and make recommendations on its management oversight. The review is a joint effort with the other members of the Oversight Group—the Evaluation Office and Operations Support Group. The report will be issued in 2002.

C. Internal audits of functions and headquarters units

21. Reports on cash management practices in the Europe and the Commonwealth of Independent States region and the UNDP Energy Account were issued, as well as a joint audit on travel services with OIOS. Each is briefly described below.

22. In response to recent audits that highlighted risks in an environment where cash disbursements are common, OAPR initiated a review to identify risks and disseminate best practices on cash management in UNDP offices in Europe and the CIS region. The review found inconsistencies between country offices with respect to cash-control procedures and made recommendations to each country office in order to streamline procedures to protect cash. As a result of the review, subsequent audits revealed that country offices with previously large cash operations had reduced their levels of cash by implementing some of the best practices used in neighbouring offices.

23. The Energy Account is a specially administered fund established by the Governing Council to undertake specific projects designed to help to meet needs in the energy sector of developing countries. Generally, the audit found that the resources of the Energy Account had been used in compliance with its mandates and, overall, was operating in a satisfactory manner. The main issue was that a single staff member was responsible for a number of key functions, which was a control risk as well as a risk to the long-term sustainability of the fund. Following the audit, UNDP has taken steps to integrate the activities of the Energy Account into those of the energy for Sustainable Development Thematic Trust Fund, which will address this issue.

24. OAPR participated in an OIOS-led audit on the contracting of travel services. This was the first of several anticipated joint audits. Since the United Nations Secretariat provides common services such as travel services and those relating to the Pension Fund, working in conjunction with OIOS ensures that UNDP concerns are addressed in the course of audits. In addition, it enhances the sharing of best practices and communication between the two organizations.

25. In addition, a number of audits were in progress as at the end of the year. These include two functional audits, rental subsidy and procurement, as well as an audit of the Special Unit for Technical Cooperation among Developing Counties and a procurement audit of the Inter-Agency Procurement Services Office, which is being conducted by a public accounting firm. The audit of procurement examines headquarters policies with respect to procurement and tests them

against actual procurement practises in country offices and at headquarters. OAPR is in the process of analysing the results of these audits.

D. Internal audits and reviews of UNDP-executed projects

26. OAPR undertakes project audits only on an exceptional basis since audits of project activities take place as part of the broader audit of country-office activities. However, for projects with significant levels of expenditures, or where problems are noted, OAPR practice is to contract with accounting firms to conduct the audit and charge the cost to the project.

27. In 2001, only one project audit was conducted: of the UNDP Cambodia Mine Action Centre (CMAC), a national institution mandated to carry out all de-mining activities in Cambodia. (UNDP has provided 88 per cent of all funding for this institution since its inception in 1994.) An audit of the ENRP projects in northern Iraq was planned but was not carried out owing to security concerns and, more recently, to the difficulty in obtaining visas.

28. Regarding the Cambodia Mine Action Centre, the scope of the audit covered $13.9 million expended from July 1999 to December 2000. The majority of this expenditure, 88 per cent, was incurred by the implementing agency, CMAC, and the balance, 12 per cent directly by the UNDP office in Cambodia. The audit noted: (a) ineffective and partial exercise of oversight and monitoring mechanisms (CMAC did not submit required reports to its oversight bodies); (b) inefficient hiring of personnel on special service agreements by CMAC; (c) weak management of non-expendable equipment; and (d) poor management of vehicle operations and costs. OAPR will follow-up in 2001 to ensure that the recommendations are promptly implemented.

E. Internal audits and reviews of country offices

29. During 2001, OAPR issued a total of 37 internal audit reports (22 full scope and 15 limited scope) and six special audit reports of country offices. A public accounting firm contracted by OAPR conducted the limited-scope audits, which focused primarily on compliance with UNDP policies and procedures in the areas of procurement, recruitment, and finance. The 37 internal audit reports contained 1705 recommendations, of which 1597 (94 per cent) were accepted by auditees and have been or are being implemented. The remaining 108 recommendations (6 per cent) are being reviewed by OAPR and, where appropriate, will be brought to the attention of UNDP senior management for follow-up action.

30. The six special audits refer to fact-finding missions carried out by OAPR at the request of senior management. The special audit reports assisted management in determining the nature and type of follow-up action, if any. Some of these special audits resulted in investigation cases, which are described in section H.

31. For each office, OAPR assessed the adequacy of internal controls according to a rating system. Generally, ratings of marginally deficient, satisfactory, or good indicate that control systems are in place although some areas may require attention. On the other hand, offices rated deficient or seriously deficient need to take prompt action to improve internal controls. Table 2 shows the breakdown by region and by overall rating of the 37 internal audit reports issued in 2001. (See annex II for an explanation of the standard audit ratings used by OAPR.)

Table 2. Internal audit reports issued in 2001, by region and rating

Region	Good	Satisfactory	Marginally deficient	Deficient	Seriously deficient	Total
Africa - full scope audits			5	3		8
Arab States - limited scope audits	1	3	2			6
Arab States – full scope audits					1	1
Asia and the Pacific – limited scope audits		1	6	2		9
Asia and the Pacific - full scope audits			1	2		3
Europe and the Commonwealth of Independent States – full scope audits		3	2	2		7
Latin America and the Caribbean – full scope audits			3			3
Total	1	7	19	9	1	37

32. OAPR analysed the 37 audit reports and summarized key issues for the attention of senior management. Specifically, the analysis focused on the increase in the number of deficient and seriously deficient ratings; audit findings which are largely unchanged from those reported in prior years; and new issues uncovered in 2001. The repeat findings and new issues are described in paragraphs 37 to 50.

33. With respect to the offices rated deficient or seriously deficient, while there has been an increase from the prior year—ten in 2001 versus seven in 2000— OAPR does not believe this increase reflects a deterioration in the country office control environment. For each of the ten offices OAPR analysed the major factors contributing to the ratings; it did not find evidence of systemic problems. Rather, many of these offices operate in difficult circumstances and require a corporate mechanism to address the problems noted by audits. This corporate mechanism is expected to take the form of an internal consulting capacity that will be managed by the Bureau of Management.

34. With respect to the repeat findings and new issues uncovered in 2001, UNDP is taking action to address the root causes. The first is training sessions for country-office staff to raise awareness of the importance of internal control. The second is establishing a task force, consisting of staff from a wide range of organizational units, to conduct an in-depth analysis of the systemic issues and prepare proposals for action to senior management. The third is rapid implementation of the new ICT strategy, which is briefly described in the following paragraph.

35. The new ICT strategy, described in document DP/2001/21, will encompass comprehensive business-process re-engineering both at the country level and at headquarters. A key component of this strategy is the implementation of an enterprise resource planning ERP software, which will be used by country offices and headquarters to support all major business processes including results-based management, project management, procurement, human resources, fixed assets, and payables. The ERP product will improve internal control in three respects. First, it will introduce system-driven controls over these processes. Second, it will enhance the ability of OAPR and other headquarters units to monitor country office operations and hold managers accountable for poor performance. Third, the accompanying re-engineering of business processes is expected to contribute to a simplification of UNDP policies and procedures, which will facilitate compliance.

36. The audit issues also need to be assessed within the context of the 2001 re-profiling exercise. This exercise has already had and will continue to have a major impact on country office operations. By early March 2002 127 country offices (94 per cent) had completed a re-profiling exercise. Missions were carried out by UNDP staff, with a total of 106 staff completing one or more missions. Most country offices have prepared and implemented actions plans to align human and financial resources around the programme practice areas; to streamline organization structures; to increase operational efficiency; and to update the office staffing profile to meet the requirements of the UNDP Business Plans. Re-profiling also highlighted the need for more rigorous performance assessment of resident representatives, particularly with respect to the management of human resources, as well as the constraints represented by out-of-date processes and systems. UNDP has taken action by revising the results and competency assessment guidelines, effective 2002, to focus more strongly on the management of human resources. Out-of-date processes and systems are being addressed as part of the new ICT strategy.

Summary of findings in human resources, procurement, programme, general administration, and office automation

37. Generally, human resources were appropriately managed. However, in a majority of the offices audited there continued to be problems with the administration of personnel holding SSAs, including lack of competitive recruitment, payments without evaluations of performance, and lack of medical clearance. Many office staff were not aware of the requirements for evaluations and medical clearance. UNDP intends to review the SSA policy framework to provide country offices with clearer guidance to address the key risk areas.

38. As noted in prior years, UNDP lacks an organization-wide system for recording personnel contracts and calculating payroll. As a result, in country offices payments must be made manually, allowing for errors and overriding of controls. For example, the retroactive signature of SSAs was noted in more than half of the offices audited and, in a few cases, they were signed after the assignment had already been completed. In addition, UNDP has difficulty fulfilling its mandatory reporting obligations to the United Nations system. Regarding the latter problem, as a stopgap measure, UNDP has requested country offices to provide a "snapshot" as at 31 December 2001 but the completeness and accuracy of this snapshot is questionable. In the longer-term, both problems will be fully addressed by the new ERP product.

39. The Country Office Suite 2001 was intended to strengthen procurement practices, primarily through controlling the creation of purchase orders and ensuring receipt of goods prior to payment. However, the procurement module is not working properly in many offices and, as a result, audits continued to observe weak controls over purchase orders (such as the lack of pre-numbering, which led to a few cases of fraudulent preparation). In addition, audits reported that some country offices made payments for goods without documenting receipt of goods.

40. Financial management in country offices functioned satisfactorily despite some recurring issues. As reported in 2001, some country offices had long-outstanding items in bank reconciliations, long-outstanding Accounts Receivable Locally (ARLs) and a somewhat liberal policy of providing salary and emergency advances to staff. In addition, despite guidance to delegate authority to the point of delivery and the commensurate redefinition of committing and verifying functions for financial transactions, some country offices still had not embraced this change. In a number of country offices, the terms and functions of those designated as committing and verifying officers did not reflect their responsibilities, which indicates a need for headquarters to provide more specific guidance and training. OAPR will follow-up with the Bureau of Management to prepare a communications strategy.

41. Programme management was also generally in line with UNDP procedures. Most of the problems noted by audits stemmed from difficulties in obtaining information from executing agencies, including final expenditure reports, annual

inventory reports, and quarterly financial reports. To some extent, the problems can be attributed to the inadequate monitoring of project activities by country offices, such as failing to ensure that work plans are submitted by executing agencies before advances are issued. In other cases, there is little incentive for the executing agencies to comply with UNDP reporting requirements, such as the submission of final expenditure reports. In late 2001, the Bureau of Management provided country offices with practical steps which may be taken when executing agencies fail to submit expenditure reports.

42. OAPR did not find any major difficulties impeding general administration but noted some areas of risk. In the majority of the offices audited, there were cases of a lack of evidence of competitive procurement and poor documentation of vendor history. In addition, some offices had not concluded a Memorandum of Understanding with United Nations organizations regarding the sharing of the cost of common premises. Where UNDP has entered into lease contracts on behalf of the United Nations system, without cost-sharing agreements in place, the risk is that UNDP may be obliged to pay the full cost.

43. With respect to office automation, recurring issues included back-ups not kept off site; untested or lack of disaster-recovery plans; and unsecured access to server rooms. While these observations pose risks, in general there was no impact on country office operations in 2001.

Problems with staffing resident representative positions

44. In four of the 37 offices audited, OAPR noted either prolonged absences at the resident coordinator/resident representative level or too frequent turnover. This is a concern because of the implications for effective operations and staff morale. While recognizing many steps in the process lie outside its immediate control since they involve the wider United Nations system, UNDP is taking steps to improve the relevant inter-agency mechanisms and its management thereof, in order to ensure the timely identification of incoming resident coordinators/resident representatives. These steps include: holding annual reassignment meetings one year ahead of time; encouraging the United Nations system to put forward fully qualified candidates for the assessment centre in order to increase the pool of pre-assessed, pre-qualified candidates; holding weekly meetings of the Inter-Agency Panel, which recommends candidates; and finally, putting in place a fast-track clearance process.

Problems administering project offices

45. In those country offices where UNDP directly executes projects, audits noted that the offices were encountering difficulties administering project offices, including uncertainty as to what actions should be delegated to project staff, how to set up and account for separate banking and cash accounts, and the legal issues to consider when entering into leases for such offices. The UNDP direct execution guidelines provide overall assistance but need to be continuously revised to reflect lessons learned. In this respect, OAPR will work with the Bureau for Development Policy to ensure that necessary revisions are made.

Problems arising from reliance on non-core resources

46. As stated in document DP/2001/21, UNDP has evolved into an organization that is funded from a number of sources – a multi-funded organization. Not surprisingly, the transition of UNDP from a core-funded to a multi-funded organization has not been without problems, a number of which are briefly described below.

47. Increasing reliance on non-core resources have strained traditional corporate systems, making it difficult for UNDP to monitor accurately the cost of country office operations and the levels and types of country office human resources; to prepare donor reports where donors have varied reporting requirements; and to report financial information in currencies other than United States dollars. With respect to the levels and types of human resources, audits observed a proliferation of contract types (Junior Professional Officers, UNV, service contracts, activities of limited duration contracts, 100 series contracts) and funding sources (projects, extrabudgetary, core). As an example, of the 85 staff in one country office, 54 were funded by the biennial budget mechanism and 31 by projects or other mechanisms, including the Junior Professional Officer programme and the UNV programme. The new ICT strategy will help address to these issues since it will result in corporate systems that meet the requirements of a multi-funded organization.

48. Country offices with minimal core resources sometimes agree to donor conditions that are contrary to UNDP policy. For example, audits noted two instances where country offices agreed to donors' requests for special audits of contributions without first seeking clearance from headquarters. In another case, UNDP agreed to a donor condition that UNDP finance project activities in advance of receipt of the contribution from the donor. This condition resulted in cost overruns because the contribution, when converted to United States dollars, did not cover the full cost of the project activities. UNDP has learned from this experience and is developing proposals to minimize these risks in the future.

49. At least one country office entered into a number of 100 per cent cost-sharing agreements with private-sector organizations, which led to questions about possible conflicts between the donors' interests and the UNDP mandate. UNDP subsequently provided much clearer guidance to country offices on working with the private sector, which should reduce the occurrence of repeat problems.

Ad hoc development of cost-recovery systems

50. In an effort to capture and recover costs, some offices have taken initiatives to develop their own cost-recovery software. While offices have developed good systems, the initiatives are being duplicated, which is not a cost-effective use of resources. The development of a corporate cost-recovery system is under way and will be completed in 2002.

F. Results of control self-assessment workshops

51. In all, 16 workshops were conducted, many with multiple sessions in order to include all staff in the offices: five at headquarters, five in Europe and Commonwealth of Independent States region, three in the Africa region, two in the Asia and the Pacific region and one in the Latin America and the Caribbean region. Most significant strengths identified were: strong commitment to UNDP and its vision; strong confidence in the skills and capacity of staff; confidence in the ability of the teams to reach their objectives. Most significant concerns include: risk assessment; ability to solve conflicts between objectives of the team and its partners; information (technology and support; safety and security of information); inadequate resources; and recognition (especially monetary compensation).

G. Analysis of audit reports for national execution projects

52. During the year, OAPR received and reviewed 1,626 project audit reports of national and NGO expenditures for 2000. The audit exercise was assessed for 110 country offices and letters were sent to the head of each office summarizing the results. As reported in paragraph 12, only five country offices failed to submit audit reports for 2000 expenditures, which is a significant improvement from the prior year, when the corresponding number was 27.

53. OAPR assessed the audit exercise according to six criteria and assigned ratings of either deficient, marginally deficient, or satisfactory for each criteria. The ratings were aggregated to determine an overall score. Of the 110 offices evaluated, only 12 were assessed as deficient, generally because the audit reports were significantly late and because the office failed to submit an action plan for following up the audit findings of the previous year.

54. OAPR summarized the significant audit findings for each project. Many of the audit findings concerned lack of competitive recruitment and procurement, poor record keeping, and non-compliance with mandatory monitoring requirements. For only three projects did the auditors raise serious concerns as to possible fraud or mismanagement of funds. For each of these three cases, OAPR is actively following up with the country offices concerned to ensure that staff are held accountable and, where appropriate, action is pursued through the local criminal system.

H. Investigation cases

55. There were 21 cases in progress at the beginning of the year, of which 14 were closed during 2001 and seven remained open at the end of the year. An additional 34 cases were opened during the year, of which 32 were still ongoing at year-end. Of the 55 cases worked on during 2001:

- 11 cases concerned the abuse of authority by senior officers, including 3 relating to rental-subsidy fraud, 3 relating to payment of personal expenses and 2 cases involving the facilitation of fraudulent visa applications. There were also cases relating to unauthorized renovations to facilities, insubordination and overexpenditure of programme resources;
- 4 cases concerning fraud in the Medical Insurance Programme;
- 28 cases involving other types of fraud, theft, financial mismanagement or irregularities;
- 3 cases relating to procurement or contracting irregularities; and
- 9 other cases involving a variety of issues, including attempted bribery, extortion and conflict of interest.

VII. Executive Board action

56. The Executive Board may wish to:

1. Take note of the report of the Administrator on internal audit and oversight services (DP/2002/12);

2. Express support for the continued strengthening of the internal audit and oversight resources of the United Nations Development Programme.

Annex I

OAPR: Organization and resources

1. Overall, the organization and level of resources is largely unchanged from those reported to the Executive Board in 2001 (DP/2001/13); OAPR continues to supplement the level of audit coverage that would otherwise be provided by staff through the use of public accounting firms and individuals on contracts for activities of limited duration (ALD).

2. A breakdown of the authorized posts, by section, is provided in the table below.

Table 1. Authorized posts as of 31 December 2001

	Total	Director	Chiefs	Auditors	Audit assistants	Support
Office of the Director	3	1				2
Internal Audit Section	9		1	5	2	1
Management Review and Analysis Section	5		1	2	2	
Audit Centre – Malaysia	4		1	2		1
Audit Centre – Panama	4		1	2		1
Audit Centre – Zimbabwe	6		1	3	1	1
Subtotal	31	1	5	14	5	6
UNFPA Audit Section	6		1	3		2
UNOPS Audit Section	7		1	5		1
Total	44	1	7	22	5	9

3. In 2001, OAPR investigative capacity was considerably strengthened through the recruitment of an experienced investigator. As reported in 2001, a vacant P-3 auditor post at headquarters was reclassified as a P-4 investigator post, to provide investigative services to UNDP, UNFPA and UNOPS.

4. Seven OAPR posts were vacant at the beginning of the year, owing to early retirements, two newly created UNFPA posts and internal transfers of staff. Of these, four were in the UNFPA Audit Section, two were in the UNOPS Audit Section and one (the investigator post) was in the Management Review and Analysis Section. At the end of the year, only the vacancies in the UNOPS Audit Section remained. The delay in filling these vacancies is because of discussions with UNOPS management concerning the changed structure of the UNOPS audit section, as well as the reclassification process, since both vacant posts were submitted for reclassification. Candidates have been identified for two of the vacant posts.

5. As reported in 2001, during the biennium 2000-2001, OAPR reduced its reliance on public accounting firms in favour of individuals on ALD contracts. This shift stemmed from unsatisfactory performance of the contractors in two regions: Latin America and the Caribbean and Africa. Since the experience with contractors in the Asia and the Pacific and the Arab States regions has been satisfactory, the use of contractors in these regions continued in 2001. The use of contractors in these regions will be assessed at the end of 2002, when the contract with the public accounting firm expires.

6. The resources referred to above have been allocated to pay the costs of 12 individuals on ALD contracts: seven are located in the regional audit service centres and five are outposted to UNDP offices in Slovakia and Cote d'Ivoire. Ten of the ALD contract holders provide audit services to both UNDP and UNFPA and two to UNDP only.

ANNEX II

Definitions of standard audit opinion ratings used by OAPR

Rating	Definition
GOOD	Those controls tested have been applied consistently and effectively. Any weakness in the application of controls was minor. No action is required by management.
SATISFACTORY	Although some weaknesses in the application of control procedures were identified, the weaknesses concerned were not sufficiently critical to compromise the system of internal control.
MARGINALLY DEFICIENT	Although the majority of key controls were being applied, the application of certain important controls lacked consistency or effectiveness. While other controls compensated in part for the weakness(es), timely corrective action is required by management.
DEFICIENT	Certain key controls were not being applied. The weaknesses identified, taken together or individually, significantly impair the overall system of internal control. Prompt corrective action is required by management to improve significantly the application of key controls.
SERIOUSLY DEFICIENT	Lack of application of internal control procedures was found to be so widespread as to undermine the system of internal control. This failure of the control infrastructure has had, or is likely to have, significant implications for security, integrity or privacy. Urgent attention is required by management to implement effective controls.

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UNOPS: INTERNAL AUDIT AND OVERSIGHT*

Report of the Executive Director

SUMMARY

The present report and its addendum contain information on internal audit assignments in 2001 for which reports were issued, and the comments of the UNOPS Executive Director on the significant findings and recommendations in the reports. It further provides an update on internal oversight matters.

* The collection and analysis of current data required to present the Executive Board with the most up-to-date information has delayed submission of the present document.

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I. Introduction

1. The oversight framework for UNOPS includes three elements: (a) external audit, performed by the United Nations Board of Auditors; (b) internal audit, performed by the Office of Audit and Performance Review (OAPR) of UNDP, under the terms of an agreement between the two organizations, for which UNOPS reimburses UNDP on a yearly basis for costs incurred; and (c) internal management oversight, which is directly associated with the self-financing principle by which UNOPS continues to operate.

2. Matters relating to external audit were covered in a separate report submitted to the Executive board at its first regular session 2002 (DP/2002/6). The remaining elements are addressed below.

II. Internal audit matters

3. In order to reflect the independent nature of the internal audit work for UNOPS, the Executive Director has decided to present the report from OAPR as a separate addendum to the present report (DP/2002/13/Add.1) rather than incorporating the findings within his report, as has been done in the past.

4. Overall, the Executive Director appreciates the collaboration with OAPR in the internal oversight of UNOPS matters. The Executive Director is satisfied with the UNOPS response to audit reports and is in agreement with audit recommendations, as reflected in paragraph 11 of the addendum. He also shares the concerns raised in paragraph 5 of the addendum with respect to the need for improvements in the implementation of recommendations.

5. A subsequent review undertaken by UNOPS management indicated that with respect to the Montreal Protocol, the outstanding recommendations are being addressed on a case-by-case basis with the assistance of the Legal and Procurement Support Division. With respect to completion of UNOPS-executed projects, a review subsequent to the issuance of the follow-up audit report has indicated that UNOPS has significantly reduced the number of outstanding projects and has put into place practical measures for monitoring closure procedures. The remaining recommendations to be implemented concern the codifying of those measures.

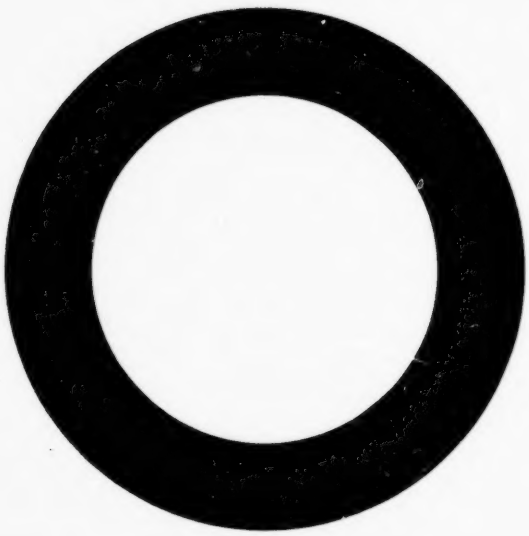
6. More importantly, as is set forth more fully below, the UNOPS Management Review and Oversight Committee, which is being established, will have as one of its focus areas the follow-up on audit recommendations in order to address any shortfalls in this area.

III. Internal management oversight

7. At the annual session 2001, the Executive Director reported on the progress made towards establishing an internal management oversight unit reporting to the Executive Director that would assist him on matters of compliance and quality assurance. The Executive Director consulted with the Under-Secretary-General for Internal Oversight Services (OIOS) on the terms of reference for such a unit. Owing to budgetary constraints, the unit has yet to be established. In addition, the Executive Director is working with the Director, OAPR towards the establishment of the UNOPS Management Review and Oversight Committee, with terms of reference similar to the committee established within UNDP, to assist the Executive Director in matters of oversight strategy, risk management, and accountability. The establishment of such a committee has been recommended by OIOS, and the Under-Secretary-General, OIOS would also serve as a member. The Management Review and Oversight Committee would work in coordination with the UNOPS Management Coordination Committee. It is expected that the Committee would be established in the second half of 2002.

IV. Executive Board action

8. The Executive Board may wish to take note of the present report.



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UNOPS: INTERNAL AUDIT AND OVERSIGHT*

Report of the UNDP Office of Audit and Performance Review to the Executive Director of the United Nations Office for Project Services on Internal Audit Services in 2001

SUMMARY

The internal audit of operations of the United Nations Office for Project Services is carried out by the UNOPS Audit Section of the UNDP Office of Audit and Performance Review. The present report contains the findings concerning 18 audit assignments in 2001 for which reports were issued.

* The collection and analysis of current data required to present the Executive Board with the most up-to-date information has delayed submission of the present document.

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I. INTRODUCTION

1. The internal audit of operations of the United Nations Office for Project Services (UNOPS) is carried out by the UNOPS Audit Section (PSAS) of the UNDP Office of Audit and Performance Review (OAPR). The present report contains the results of 18 audit assignments for which reports were issued in 2001.

2. PSAS has six posts: Chief of Section, four Audit Specialists and one Audit Associate. Two auditor posts were vacant in 2001; the main delay in filling them was caused by a decision made to change the structure of PSAS and the consequent process of reclassifying the two posts. At its meeting on 31 January 2002, the UNDP Appointment and Promotion Board approved the selection of the candidates that were identified and recommended for the posts. The candidates' entry-on-duty dates are expected to be in the early part of the second quarter of 2002.

3. In 2001, as in previous years, OAPR conducted internal audits of both headquarters and field activities. Of the 18 audit assignments, three are management audits of UNOPS operating divisions or units; three are management audits of UNOPS-executed projects; eight are either functional or financial audits relating to the provision of UNOPS services under project activities; one is a special audit of a UNOPS-executed project; and three are follow-up audits relating to the implementation of recommendations made in previous audits.

II. HEADQUARTERS AUDITS

4. At headquarters, audits were performed of: (a) the Division for West Asia, Arab States and Europe; (b) the Division for Environmental Programmes; and (c) the personnel component in a cluster of regional projects. The audits found:

   (a) Division for West Asia, Arab States and Europe (WAASE). There were no major areas of concern since OAPR considered the overall level of internal control to be satisfactory. OAPR noted that the Governance Unit was a thematic unit within WAASE yet it had no terms of reference nor was there any indication of a justifiable reason for its inclusion in the Division. It was not clear to whom the staff members within the Unit should report (i.e., to Head of Unit or the Chief, WAASE).

   (b) Division for Environmental Programmes. OAPR considered the overall level of internal control to be satisfactory. OAPR noted that, following an internal reorganization of the Division carried out early in 2001 there was a need to review the levels of posts of cluster coordinators and the related terms of reference. Also, some support staff holding special service agreements had been performing core functions far exceeding the established time limits for this type of contractual arrangement.

   (c) Personnel component in a cluster of regional projects in the Division for Africa I. The main issue was that while on the cover pages of all the legal instruments (i.e., project documents) underlying the projects audited, UNOPS was indicated as the executing agency, its actual role and responsibilities with regard to some of the projects was considerably short of covering the overall management of these project activities, which, by the definition of UNDP Financial Regulation 27.02, the term "execution" represents. In these cases, UNDP has played a substantive role in recruiting and hiring candidates and authorizing travel to be taken under some of the projects. Project personnel often did not report to an official within UNOPS, but to an official in UNDP or another United Nations organization involved in the project concerned.

5. Follow-up audits were also made on earlier audits of the completion of UNOPS-executed projects and the UNOPS execution of projects under the Multilateral Fund for the Implementation of the Montreal Protocol. The results indicated an unsatisfactory rate of implementation of the audit recommendations. In the case of the completion of UNOPS-executed projects, out of the 21 recommendations contained in

the 1997 audit report, 11 were considered principal recommendations; of these, only one was implemented, four were in progress and six not implemented. Concerning the Montreal Protocol follow-up, of the 10 recommendations made in 1997, six were considered principal recommendations; of these, four were in progress and two were not implemented.

III. FIELD AUDITS

6. The audit of field activities included a special audit of a Global Environment Facility Small Grants project activity in Asia that was carried out as a result of allegations made regarding the management of the project in which UNOPS is involved. The primary objective of the audit, which was to ascertain the validity of the allegations, focused on the following areas: (a) processes and procedures relating to the awarding of grants to community groups and non-governmental organizations (NGO); (b) personnel management and administration functions; and (c) selected 1999 and 2000 transactions in order to assess the adequacy of the financial operations and general administration functions. OAPR determined that the main allegations relating to programme management and sub-project monitoring were not substantiated. There was no documentation and no information to substantiate the majority of the allegations. However, a main allegation relating to the treatment of staff, while deemed to be inconclusive, led to audit observations that there were serious shortcomings regarding personnel relations as well as a lack of compliance with personnel procedures. The only four allegations that were substantiated pertained to general administration activities and related administrative budget and expenditure. Although the specific activities were not in line with UNOPS and UNDP procedures, the amounts involved were considered immaterial. In these cases, the audit team did not find documentation or information to indicate that the project personnel concerned gained personally from such activities.

7. A project audit was carried out in Asia because of UNOPS management concerns with regard to the payment of salaries to part-time personnel within a key entity involved in the project. The audit focused on activities carried out under a subcontract arrangement between UNOPS and the entity. The main issue concerning the related contract was a claim by the entity for payment under the personnel component of $78,000. Since the claim had not been satisfactorily supported, the responsible UNOPS office withheld payment for this component pending the audit review of the additional explanation and justification by the entity. The audit confirmed that the action taken by the entity in relation to the discrepancy in supporting payments for the personnel component was incorrect and had misled UNOPS in its review of the supporting documentation. Nevertheless, there was evidence that personnel work had been undertaken in organizing, coordinating and holding the required preparatory meetings and annual conference, which were in line with the "Statement of Work" set out in the contract. However, the extent and value of such work needed to be reviewed further by UNOPS in order to arrive at a mutually agreeable reimbursable cost for the personnel component.

8. An audit of the UNOPS financial statements covering a project activity in Asia was carried out at the specific request of UNOPS management because of some difficulties between the parties concerned. It was agreed between UNOPS management and OAPR that the latter would prepare a report on this review in which, based on its audit, it would express an opinion on the financial statements concerned. The audit opinion was expressed that the financial statements present fairly the financial position of the project activity in respect of the income and the cumulative expenditure of project activity for the period concerned. The total management fee shown in the financial statements was stated to be in conformity with the amount of the total management fee agreed on by the two parties in the underlying contract agreement. A supplementary report was also prepared to provide information regarding the detailed adjustments to the expenditure records of the project as well as to highlight issues relating to weaknesses in internal control noted during the review. As the project was in its final stages, the recommendations and suggestions were provided in the context as lessons learned for future endeavours of a similar nature. The issues raised included observations on (a) the implementation of project activities started almost six months before the receipt of funds from the Government concerned, which is in

violation of UNOPS Financial Regulation 5.5 and (b) bi-monthly statements of expenditure and payment requests were not prepared and submitted to the Government as required in the contract underlying this activity.

9. Other field audits included (a) those of an implementation facility; (b) activities carried out within the framework of project; (c) activities carried out within a specific agreement between UNDP and the World Bank; and (d) a follow-up audit, the main results of which are as follows:

(a) As regards the audit of an implementation facility in Asia, OAPR stated that although the majority of key controls were being applied, especially in the procurement of goods and services, which constitutes a large part of the operation of the facility, there was a need to improve on the application of certain key controls;
(b) In the report on a Global Environment Facility Small Grants project in the Arab region, the overall internal control was considered to be satisfactory;
(c) In the report on the audit of a project in Africa, it is indicated that there had been considerable delays in the implementation of project activities. More importantly, major inputs identified in the project document, such as the key planning instruments that were essential to carry out the "pilot phase of the project" were delayed;
(d) In the report on an audit of a group of three projects in Africa, the overall level of internal control with regard to the operations of the projects was considered marginally deficient;
(e) OAPR considered the overall level of internal control, which focused on procurement activities and related controls in project activities in the Latin America and the Caribbean Region to be satisfactory.
(f) The follow-up audit on a 1998 audit of one of the UNOPS divisions away from headquarters indicated that regarding the nine recommendations made in 1998, of the four that were considered principal recommendations, three had been implemented while one was still in progress.

IV. AUDIT OF MANAGEMENT SERVICE AGREEMENT ACTIVITIES (WORLD BANK)

10. In addition to the audits discussed in chapters II and III, audits were carried out, both at headquarters and in the field, of management and other support services (i.e., management services agreement, MSA) provided by UNDP through UNOPS under Letters of Agreement between the Borrowing Governments and UNDP with respect to activities financed from World Bank loans. The audits were carried out pursuant to an agreement reached in May 1992 between the World Bank and UNDP, on behalf of UNOPS, on the audit modality of MSAs. Under that modality, UNOPS provides the Borrowing Governments with audited financial statements for each MSA with expenditure above $100,000 during the fiscal year under consideration. In 2001, reports on audits of four government funded/World Bank-financed MSA activities, with total expenditure in 2000 of $3.2 million, were issued in July 2001. For all of these, the opinion was expressed that the "financial statements present fairly the financial position [...] as at 31 December 2000 and the results for the financial period then ended. The transactions were in accordance with the relevant legislative authority in all material respects."

V. AUDIT RECOMMENDATIONS

11. A total of 121 recommendations were contained in the audit reports issued in 2001. These were in the areas of finance, personnel, administration (which includes contracts and procurement), programme, management and policy. UNOPS provided comments on 118 of the 121 recommendations issued, and agreed and/or provided additional information on all of the 118 recommendations it has commented upon.

12. It should be noted that because of the special nature and purpose of the reports on the audit of the government-funded MSAs financed by the World Bank, those four reports do not contain recommendations. Similarly, four other reports do not contain recommendations. These include three reports on the follow-up on actions taken with regard to the recommendations made in previous audit reports that contain a detailed account of the status of implementation of recommendations made relating to the earlier audits.

VI. EXECUTIVE BOARD ACTION

13. The executive Board may wish to take note of the present report.